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# RURAL BRIEF
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## Welcome to this latest issue of the Knight Frank Rural Brief

**The start of 2009 looks a very different place for farming and the economy as a whole, compared with the sense of optimism that ushered in last year.**

**Cereal prices are significantly lower, while the property market is facing its most turbulent time in memory. The base rate has been slashed to its lowest level ever and the pound has lost 25% of its value against a backdrop of company failures and job losses.**

**A falling pound, however, is generally considered helpful to farming and lower cereal prices are good news for livestock farmers. Input costs have also started to fall.**

**This Rural Brief discusses these and other key issues affecting farmers and landowners. I hope you find it useful and informative.**

### Headlines

- **Land values start to fall, according to Knight Frank Research**
- **Farm incomes set to fall in 2009**
- **Rural planning controls eased**
- **Prime country property slides**
- **New set-aside threat**
- **VAT change hits tenancies**
- **Biomass on the rise**
- **Pesticide cuts confirmed**
- **Supermarkets pile on pressure**

# FARMLAND MARKET –
## Values start to fall, but downside limited

Last year was a mixed one for the land market. Values raced ahead during the first half of the year as a mix of potential buyers vied for the limited amount of land available. Even while the residential and commercial markets were sliding, farmland remained buoyant.

But by the end of the summer, the cracks were starting to show. Falling commodity prices and rising input costs combined with the credit crunch to stifle demand as investors, lifestyle buyers and farmers from the UK and abroad all withdrew from the market.

While values only fell slightly during the third quarter of the year, a more significant decline was recorded in the final three months of the year by the Knight Frank Farmland Index. The price of English farmland fell by 5% to average £4800/acre, but the strong growth earlier in the year meant prices still finished 2008 16% higher than they were at the end of 2007.

The big question now is how much of that growth will be eroded in 2009. We are predicting a further decline of 6%, but expect the market to level off during the year. While such a fall appears modest against the more dramatic peak-to-trough expectations of 25-30% for residential property, the farmland market still has inherent strengths that should prevent a bigger slide.

Availability did increase during 2008, but remains historically low. Farmers will always be keen to buy good blocks of land that enhance their existing holdings and the fall in values should also encourage some investors and "deal hunters" who did not want to commit at the peak of the market.

**Farmland prices** (£/acre)


Source: Knight Frank Research

# FARM PROFITABILITY SET TO FALL IN 2009

**We may look back at the first half of 2008 as a golden period for farming. Cereal prices were climbing ever higher as investors piled into agriculture and farmers felt somewhat more optimistic than in previous years. Tractor sales were 10% up on 2007 with more vehicles sold than in any year since 1996.**

Although torrential rain meant a pretty torrid harvest for many arable farmers, the UK still produced a record 17.5m tonne wheat crop and Total Income From Farming (TIFF) for 2008 is estimated to have increased by a third to £3.5bn, according to consultant Andersons.

TIFF, however, is likely to fall to below £3bn this year on the back of significantly lower grain prices and increased fertiliser costs. Although the cost of many fertiliser products has now started to fall, along with oil prices, the majority of nitrogen destined for the 2009 crop was purchased when prices were at record highs.

Consultants suggest that an average arable business will need to achieve a wheat price of about £120/t just to break even this year. Prior to Christmas this looked unlikely, but markets have already rallied somewhat in the new year with spot prices climbing to over £100/t. November 2009 futures prices have risen to over £120/t. The fall in the value of Sterling has helped make UK exports more competitive on the world market. It will also help boost subsidiary payments which are set in Euros.

Early estimates suggest that EU cereal production could fall by around 6% this year following the drop in prices and poor autumn sowing conditions in some areas like the UK. This could also help support prices, but EU production is still set to be significantly higher in 2009 than the three-year average and world grain stocks have increased. Price volatility is likely to continue, meaning careful crop marketing will be more vital than ever.

Sterling's decline has also helped the livestock industry and beef prices climbed steadily during 2008. A declining UK cattle herd and limits on Brazilian imports should help to sustain values, but these could come under pressure if consumers start to cut back on meat consumption or choose cheaper cuts as the global recession bites.

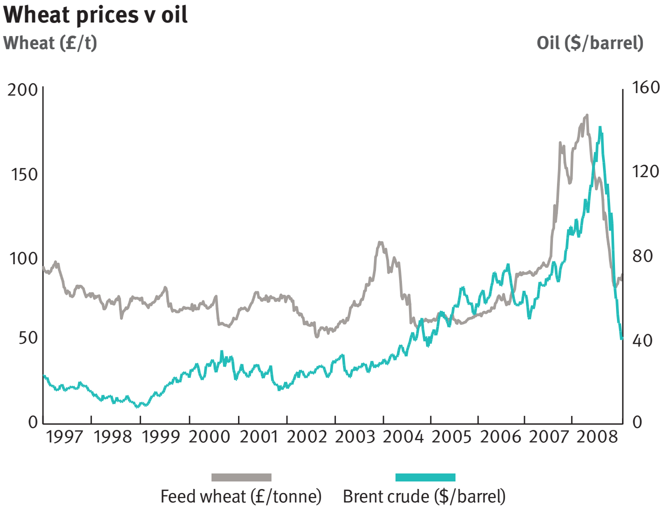
A drop in the value of dairy commodities is already starting to hit dairy farmers with several milk buyers cutting their prices since the beginning of the year. The number of milk producers in England has now dropped below 10,000 for the first time.

**Agricultural price changes 2007-2008**

| Commodity prices | Dec 2007 | Sept 2008 | Dec 2008 | Quarterly change (%) | Annual change (%) |
|---|---|---|---|---|---|
| Feed wheat (£/t ex-farm) | 165 | 95 | 90 | -5.3 | -45.45 |
| Oilseed Rape (£/t ex-farm) | 281 | 277 | 231 | -16.6 | -17.79 |
| Cattle (R4L steers p/kg dw) | 216 | 285 | 278 | -2.5 | 28.70 |
| Sheep (R3L lambs p/kg dw) | 204 | 291 | 292 | 0.3 | 43.14 |
| Pigs (DAPP p/kg dw GB av) | 110 | 136 | 131 | -3.7 | 19.09 |
| **Input prices** | | | | | |
| Red Diesel (p/litre) | 50 | 58 | 41 | -29.3 | -18.00 |
| Oil ($/barrel Brent Crude) | 98 | 93 | 43 | -53.8 | -56.12 |
| Fertiliser (£/t AN 34.5%) | 255 | 376 | 381 | 1.3 | 49.41 |
| Soyameal feed (Argentine £/t) | 238 | 242 | 237* | -2.1 | -0.42 |
| **Economic indicators** | | | | | |
| Interest rates B of E base %) | 5.5 | 5 | 2 | -60.0 | -63.6 |
| Inflation (CPI) | 2.1 | 4.7 | 4.1* | -12.8 | 95.2 |
| £:€ rate | 1.36 | 1.25 | 1.02 | -18.4 | -25.0 |
| £:$ rate | 1.98 | 1.8 | 1.46 | -18.9 | -26.3 |

*November Figures

**Wheat prices v oil**




Sources: Farmer Weekly, DairyCo, DEFRA, Knight Frank Research, HGCA, EIA

# MORE HOUSES FOR THE COUNTRYSIDE?

The government wants to ease rural planning restrictions in a bid to provide more affordable housing in the countryside and help achieve its ambitious, but credit-crunch affected, target of building three million new homes by 2020.

A report due out early this year is expected to give councils the power, or even force them, to overrule normal planning curbs, provide incentives for farmers to sell land to developers and identify plots in every village where affordable housing is needed.

Such a move is bound to be controversial, with many rural dwellers vehemently opposed to increased growth. Others argue that communities should be allowed to grow to safeguard the dwindling number of pubs, shops, post offices and other services left in the countryside.

# PRIME COUNTRY HOUSE MARKET BOTTOMING OUT

The market for top-quality rural housing looks set to stabilise this year as vendors become more realistic. According to the Knight Frank Prime Country House Index, average prices have now fallen by 16% from their peak at the beginning of 2008.

**2008 price change by sector**

| Property Type | Quarter 4 price change % | Annual price change % | Average value £ |
|---|---|---|---|
| Cottage | -8.3 | -17.9 | 0.46m |
| Farmhouse | -8.3 | -15.6 | 1.1m |
| Manor House | -10.6 | -15.1 | 2.7m |
| Unweighted average | -9.0 | -16.2 | 1.4m |

Over half of this fall came in the final three months of the year with a drop of 9% – the sharpest decline in the history of the index. This reflected the realisation that even the top of the market cannot remain immune to a global recession for ever.

Although the market will remain tough this year, we believe that it is close to reaching the bottom of the current cycle. There is still limited availability of the very best houses and interest rates are falling for those with access to reasonable deposits. Minimal returns on cash deposits and the ongoing volatility of the stock market could also encourage a move back into bricks and mortar in 2009.

# SET-ASIDE TO RETURN IN DISGUISE

EU farm ministers finally thrashed out an agreement on the “health check” of the Common Agricultural Policy at the end of last year. As expected, one of the decisions was to abolish compulsory set-aside – the requirement for farmers to leave 10% of their land fallow each year – following concerns over world food security.

That has not stopped the UK government pressing ahead, however, with its own environmental agenda that seems likely to require at least some land to be taken out of intensive production. Speaking at the recent Oxford Farming Conference, DEFRA secretary Hillary Benn said he recognised the need for farmers to produce as much food as possible, but this could not be done at the expense of the environment.

He denied there would be a return to compulsory set-aside; instead farmers would need to manage a “small percentage” of their land environmentally. The percentage will be confirmed in the spring said Mr Benn.

Some farm wildlife groups fear the scheme could be counterproductive. There is already some evidence to suggest farmers are putting on hold applications to join existing environmental schemes because they are concerned about the impact of any additional DEFRA requirements.

# ANAEROBIC DIGESTION GETS A BOOST

Farmers and landowners could benefit from a number of initiatives to promote energy production from anaerobic digestion (AD) and biomass.

The Environment Agency has announced that it is reclassifying anaerobic digestate produced from on-farm manure, slurry and crops from a waste product to fertiliser. This means farmers will no longer need to apply for a waste permit to spread the digestate on their fields, as long as it is not combined with other products like food waste.

Banding within the government's Renewable Obligation will also be introduced in 2009. This means that technologies like AD and biomass heat-and-power plants, which are currently uneconomic under existing incentives, will now receive two Renewable Obligation Certificates (ROCs) per MWh of energy produced. ROCs can be traded for £40-£60 each.

# VAT CUT FREEZES TENANCIES

The government's decision to cut the rate of VAT from 17.5% to 15% from 1 December 2008 in a bid to boost consumer confidence could have unintended, but serious, implications for a significant number of agricultural landlords and their tenants with traditional tenancy agreements. Farm Business Tenancies will not be affected.

Many landlords, especially large institutions, charge VAT on rents. A recent court case ruled that VAT should be considered part of a tenant's rent. This means that the VAT cut has effectively reduced rents. Under the terms of the Agricultural Holdings Act, neither tenant nor landlord can obtain a rent review settlement by arbitration for three years following any change in rents, according to specialist law firm Burges Salmon. This effectively freezes rents for those affected until 2011.

The government plans to reverse its VAT cut at the beginning of 2010, which would extend the freeze for another three years.

The Tenancy Reform Industry Group, which represents both landlords and tenants bodies, will be meeting soon to try and find a way to resolve the issue. This may, however, require parliamentary legislation, which is unlikely to be a government priority.

# PESTICIDE WORRIES CONTINUE

An EU proposal to reduce the number of chemicals available to farmers is virtually a done deal, awaiting only the approval of MEPs and the rubberstamping of the EU's agricultural council.

Although some concessions have been won by groups campaigning against the restrictions, the production of fruit, vegetable and horticultural crops could be severely hampered and some key triazole-based chemicals, which are crucial to controlling Septoria in wheat crops, could be under threat. Opponents acknowledge the need to protect the public and environment, but question the scientific basis of some of the EU's conclusions and worry about the impact they will have on food production and security.

In a further blow, veteran pesticide campaigner Georgina Downs won a court battle last November that could force arable farmers to create spray buffer zones around settlements that would be so large as to make crop production unviable. DEFRA has been granted leave to appeal against the decision.

# SUPERMARKETS APPLY THE PRESSURE

The recession means an ombudsman is now even more vital to ensure supermarkets treat farmers fairly, say farming organisations. Retailers, desperate to retain customers, are cutting prices drastically and it is feared that the cost will inevitably be passed back to suppliers. Retailers say the cost of increased regulation would have to be passed on to customers.

# UGLY VEG U-TURN

This year could see the return of less-than-perfect fruit and vegetables to supermarket shelves following a recent EU vote to repeal regulations that restricted the sale of misshapen or under-sized produce.
The widely lampooned laws infamously specified the bendiness of bananas and meant perfectly edible fruit and vegetables were wasted or forced into low-value markets.

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# READY TO HELP –

**Knight Frank offers a wealth of in-depth specialised experience covering the rural property sector. Please get in touch with any of our experts if we can be of any help to you or your business.**

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